

ECB: Here we are now, enter-tier us

While tiering currently looks like the next big thing for the ECB, the minutes of the March meeting support our view that today's ECB meeting will not yet deliver any final decisions



European Central Bank HQ, Frankfurt

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Even the ECB cannot escape seasonal distortions. The Easter break has somehow mixed up the ECB's usual schedule. The minutes of the March meeting were only released four weeks and not three weeks after the meeting and the next policy meeting is five weeks and not six weeks after the last meeting. And, on top of that, the meeting falls on a Wednesday, not on a Thursday. Looking through all these calendar mix-ups, however, we can see that the ECB has become increasingly concerned about the economy and inflation ever reaching the ECB's target.

The minutes of the March meeting illustrated the ECB's growing concerns about the economic outlook for the eurozone, doubts about any sustainable convergence of inflation to target and an awareness of negative side-effects on the banking sector. Interestingly, some ECB members were contemplating labelling the risks surrounding the eurozone outlook as balanced.

From review to preview

The minutes, as well as recent comments by ECB President Mario Draghi and Chief Economist Peter Praet, signal that the ECB is investigating whether and how the bank should provide some relief to

the banking sector. Also, don't forget that the ECB still has not explained what the so-called built-in incentives in the next TLTROs could be. In our view, there is no rush to present any details this week. Instead, we expect the ECB to wait until the June meeting.

Up to now, the overwhelming "official" view of the ECB has always been that negative interest rates have been good for the economy, with hardly any negative effects on banks. The latter part of this view has now started to shift, even though one should not forget that all targeted longer-term refinancing operations (TLTRO) up to now have been instruments to mitigate adverse side-effects on banks due to the built-in incentives. At the same time, the ECB will always have to find a monetary policy reason to justify any mitigating measures. Indeed, there are currently much bigger challenges for banks' profitability than the negative deposit rate, and a tiering system will not make an unprofitable bank suddenly profitable. Therefore, the ECB will have to investigate whether the negative deposit rate actually leads to a smaller (or more expensive) supply of loans than a zero deposit rate or a tiering system.

Will the ECB enter-tier us?

There are at least four considerations the ECB will have to assess before introducing a tiering system:

1. It could be perceived as a sign that the ECB is preparing for a "low for much longer" period and even open the door for further rate cuts
2. It could actually complicate the pass-through of monetary policy to the real economy; depending on the technical details of such a system
3. Rapid introduction of a tiering system could be perceived as yet another "free lunch" for the banking sector
4. While a tiering system would open the door to further rate cuts, these cuts would mainly be seen as exchange rate manipulation rather than supporting the bank lending channel

All in all, reviewing the ECB minutes and previewing today's ECB meeting, we do not expect the bank to announce further details of the built-in incentives for the next TLTROs or of any tiering system already. The ECB will continue its balancing act between demonstrating that it is not running out of ammunition while still keeping some cards to its chest. The most likely next step is still the announcement of the detailed conditions for the third batch of TLTROs (at the June meeting). Introducing a tiering system will be investigated but probably only announced in case the economy has not started to rebound by June.

Still, "tiering" remains the current buzzword in the ECB universe. Many financial market participants are getting overly excited about possible new steps by the ECB, even though it is clear that the real answer to tackle any next protracted economic slowdown in the eurozone should come from fiscal, not monetary policies. Back in March, Draghi talked about a dark room, in which "you don't run but you do move". Back in the good old days, Kurt Cobain sang "with the lights out, it's less dangerous" but today we don't expect the ECB to entertain us.

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